

Questions from Representative John Lewis

Question 1: An observation was made during the hearing that retirees who were expecting a 6 or 8 percent return on their retirement investments were sorely disappointed in their ability to retire on account of the recession and the drop in asset values. Could you please explain the advantage that a defined benefit plan offers to participants in contrast to a defined contribution plan in terms of retirement asset volatility and any one participant's expected retirement date?

Answer 1: In a defined contribution plan, the employee bears the entire risk for his or her retirement security. There are at least two kinds of risk that employees bear. 1) During his or her working lifetime, he bears the risk that he will make the right kinds of investments to grow the account to a sufficient size to allow a decent income in retirement. This can be extremely difficult for an unsophisticated investor. 2) In addition, there is a risk of the timing of retirement. Many holders of defined contribution plans want to "annuitize" their accounts at the time of retirement so that they will receive a steady stream of retirement income over their remaining life. The monthly annuity they would receive, however, is highly dependent on the amount in the account at the time of retirement, so an employee who retires during a down market such as in the recent recession is unlikely to have sufficient income from his or her defined contribution plan.

By contrast, a defined benefit plan pools the risk of all the employees in the plan. It utilizes professionals to invest its assets and generally experiences lower investment fees, so money invested is likely to grow at a more rapid rate. In addition, a pension fund has a long time horizon. An employee who retires during a down market can still get his or her full pension, because the plan can recoup investment losses at a later time. No individual employee suffers because of the timing of his or her retirement.

Question 2: You were asked during the hearing whether H.R. 567 was good for employees and you responded that, while transparency is good, the disclosure required under H.R. 567 would not result in transparency. Could you please provide more detail on this point?

Answer 2: The term "transparency" implies that the public will be provided with useful information to help them understand the issue that is the object of the transparency. The term "transparent" means "readily understood." As I have testified, I believe that H.R. 567 would sow confusion rather than clarify the funding status of state and local pensions. The calculation of liabilities based on using Treasury Bond yields that is required by the legislation would likely lead the public and many policymakers to believe that the amounts that states and localities need to deposit in their pension plans each year are substantially larger than the amounts actually needed. Thus the data that would be provided under this legislation would not help make pension funding more understandable, but in fact would obfuscate the issue to some degree.